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Director of
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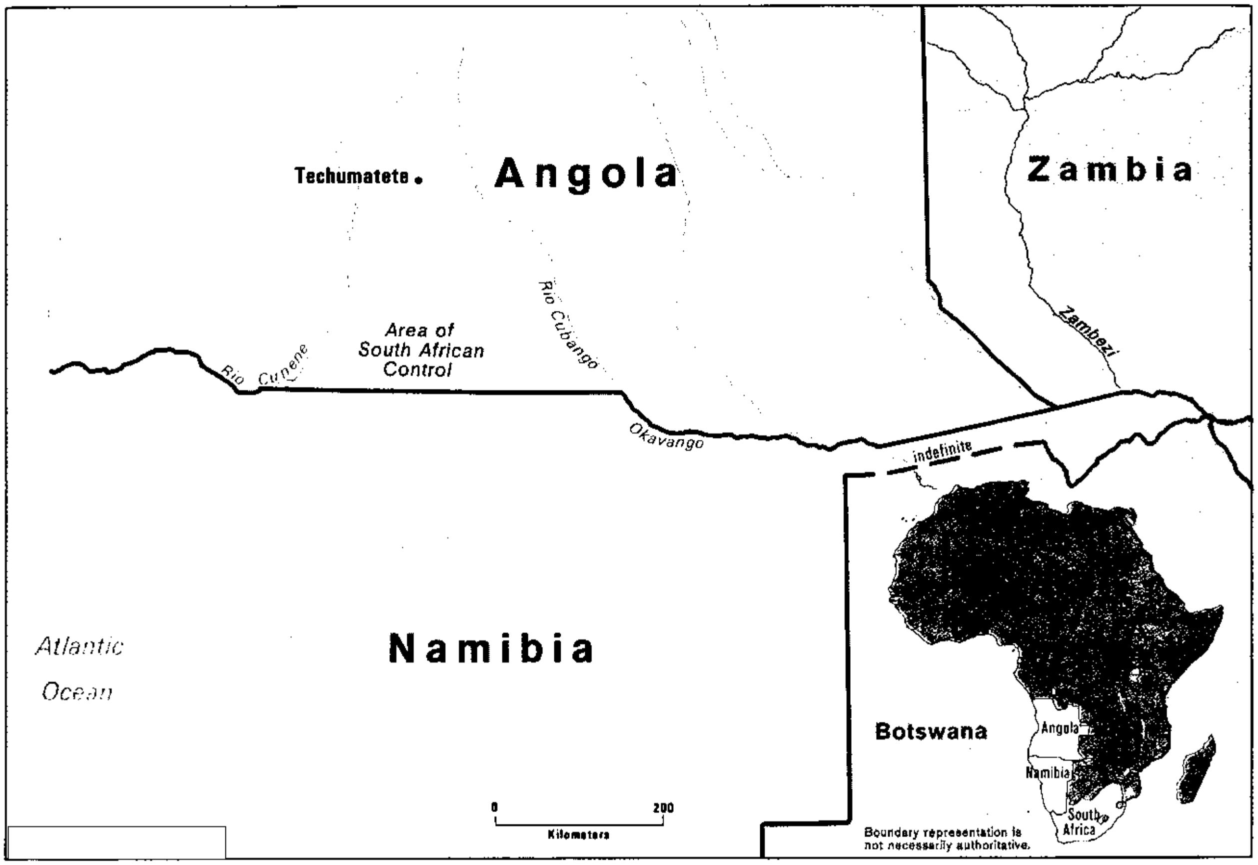

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10 SOUTH AFRICA - ANGOLA: Military Developments

There are conflicting claims about the military situation in southern Angola. The Angolan Government alleged on Wednesday that South African attacks were still under way, but Pretoria has assured US officials its forces pulled back over a week ago. The South Africans also are claiming that their recent operation involving between 1,200 and 1,500 men only extended as far north as Techumatete. [redacted]

Comment: The South Africans probably are drawing back toward their customary zone of control in southern Angola, although most units that participated in the recent large-scale operation may not yet have crossed back into Namibia. Pretoria evidently believes its attack on the forward bases of the South-West Africa People's Organization will impede the insurgents' ability to infiltrate Namibia and that more ambitious operations at this time would disrupt the settlement talks. [redacted]

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SPECIAL ANALYSIS

12 MEXICO: Increasing Economic Problems

[redacted] 25X1

The Mexican Government will soon have to make severe cuts in domestic economic programs and to take other painful steps if it is to obtain IMF support and regain the confidence of the international financial community. The indecisiveness of a lameduck President and the difficulty of gaining a political consensus in support of a program that is bound to hurt many interest groups make it likely any policy adjustments will be reluctant, tentative, and slow. Eventually the economy will achieve a new stability because there is little choice. [redacted] 25X1

Mexico's failure to deal resolutely with mounting economic problems has led to more frequent private business failures, another substantial devaluation, inflation soaring to near a 70-percent annual rate, and a liquidity crisis. Mexico has virtually run out of foreign exchange and has a foreign debt of $80 billion, including more than $30 billion due to be repaid within a year. [redacted] 25X1

Service obligations on long-term debt alone total nearly $1.75 billion per month, or nearly 90 percent of export earnings. If short-term debt cannot be refinanced--and banks have become reluctant to do so--debt service obligations will soon double to $3.5 billion a month. [redacted] 25X1

Mexico has secured some $2.5 billion in emergency aid from the US and major central banks and has obtained permission from commercial banks to suspend debt repayments to them temporarily. Those measures are designed to give Mexico time to negotiate with the IMF on economic stabilization and with the commercial banks on long-term debt rescheduling. [redacted] 25X1

Necessary Measures

Economic stabilization will carry potentially disruptive political ramifications. Mexico City began to lay

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the groundwork last April, when it announced at 17-point austerity program. It failed to put much of the program into effect, however, because of reluctance to antagonize domestic interest groups. [redacted] 25X1

Appropriate measures will inevitably involve a reduction in labor's purchasing power and virtually halt economic growth. Mexico City also will need to increase oil exports by cutting domestic consumption and by increasing investments to boost productive capacity. [redacted] 25X1

Real wages will fall, in contrast to the aftermath of the devaluation last February. At that time, wages were raised more than enough to compensate for lost purchasing power. [redacted] 25X1

Capital expenditures by the government will be cut further. Cuts in current spending, moreover, will affect both federal employment and price subsidies on food, fuel, and other goods and services--worth at least $20 billion last year. [redacted] 25X1

Although Mexico will face pressure from the IMF to decontrol most prices, heavy lobbying from labor almost certainly will keep controls on many basic foods. Nevertheless, the price of tortillas, gasoline, and subway fares may have to be increased several fold. [redacted] 25X1

The IMF will demand the quick abandonment of Mexico City's new multiple foreign exchange system, which was established to take pressure off the peso and assure orderly debt repayment. Foreign trading partners will welcome reduced restrictions, as will consumers, but some inefficient producers will go out of business. [redacted]

<u>Political Factors</u> 25X1

Only President Lopez Portillo can get the program off to a good start. He has the authority to take the difficult steps required to end the economic chaos, but his self-esteem has been shattered. [redacted] 25X1

[redacted]

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[redacted] 25X6

The Finance Minister--a close associate of President-elect de la Madrid--has announced the recent moves, but he lacks the stature among Mexicans to build a consensus for an austerity program that is widely seen as both necessary and equitable. [redacted] 25X1

De la Madrid is involved in the program but probably will not accept a leading role, in order to avoid limiting his future policy options. He also wants to protect the mandate he won in the election. [redacted] 25X1

Labor is the largest source of support for the ruling Institutional Revolutionary Party, but the unions also could mobilize popular protest. Mexico City cannot risk alienating them. [redacted] 25X1

Major labor groups are demanding price controls, and others have called for wage hikes. Negotiations for the annual wage increases on 1 January are slated to begin next month. Meanwhile, labor is taking a wait-and-see attitude. [redacted] 25X1

Business has already suffered the most from the halting austerity measures, and it is likely to welcome the greater policy predictability inherent in an IMF program. As business failures mount, however, policies on prices, credit, and trade that are part of the austerity package will come under fire. [redacted] 25X1

Opposition parties have an unprecedented opportunity to increase their popular appeal. Because the ruling party is politically astute and it is willing to use force, however, it will put up a strong defense against any challenges. [redacted] 25X1

The public has to be convinced the situation is serious enough to warrant the measures the government is proposing. Foreign creditors will be looking to see whether the government has the will to take the necessary steps. [redacted] 25X1

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Crucial Time Factor

Developing and negotiating a comprehensive policy package will be time consuming and will be affected by several important events in the next few months. Most price controls will expire this month, Lopez Portillo will deliver his final state-of-the-nation address on 1 September, Mexico has to reach an agreement with the IMF by mid-October, and the new administration takes office on 1 December. Until the implications of these developments become clear, foreign creditors will remain nervous, and Mexico's financial situation will be precarious. [redacted]

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Civil unrest is a possibility at every stage. The longer the delay before the scope of the austerity program is apparent, the greater the likelihood of social and political turmoil. [redacted]

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